

JANUARY 2001

CAUTIOUS CREDITOR®

DISPOSITION OF COLLATERAL UNDER THE UCC: THE PRESENT AND THE FUTURE

Indiana's version of the Uniform Commercial Code (UCC) governs, among other matters, foreclosure of security interests in personal property. After a debtor's default, the secured party may sell, lease or otherwise dispose of collateral in a commercially reasonable manner. If a secured party improperly disposes of collateral, the secured party may lose the opportunity to recover a judgment for any deficiency. The secured party is required to give the debtor reasonable notice of the disposition. Absent proper notice to the debtor, the secured party seeking a deficiency must overcome a presumption that the reasonable value of the collateral at the time of the sale was equal to the amount of the debt.

IMPROPER DISPOSITION OF COLLATERAL - NO RIGHT TO DEFICIENCY

In a recent Indiana case, *Walker v. McTague*, 737 N.E.2d 404 (Ind. Ct. App. 2000), the creditor sold a business and personal property to a corporation pursuant to a sales contract. The purchaser made a down payment, agreed to make additional payments over five years and also signed a lease. Shareholders of the purchaser guaranteed the purchaser's obligations. The purchaser granted the seller a security interest in virtually all of its assets. The purchaser defaulted, owing more than \$250,000 of the purchase price and \$7,400 of rent.

The seller, as the secured party, obtained possession and control of the collateral. It placed notices of a sealed bid auction of business assets in two newspapers, but did not notify the debtor, the guarantors or their attorney of the auction. An entity controlled by the secured party submitted the only bid. The secured party then sued the guarantors to recover the unpaid purchase price and rent, less a credit of \$50,000 received at auction. The trial court entered judgment for the secured party against the guarantors on the unpaid rent, but denied other relief. The trial court held that the secured party impaired the collateral

by the manner in which it operated the business prior to the sale. (Impairment of collateral involves the secured party's release of or failure to preserve collateral put in its control by the principal debtor.) The trial court also held that the secured party did not conduct the sale in a commercially reasonable manner. The secured party appealed.

The Indiana Court of Appeals first examined the disposition of the collateral and agreed with the trial court that: (1) the secured party failed to overcome the presumption that the value of the collateral at the time of sale was equal to the amount of the debt, and (2) the sale was not made in a commercially reasonable manner. The court affirmed the judgment for the secured party for the unpaid rent and denied the secured party all other rights to collect a deficiency against the guarantors.

The court dealt with the impairment of collateral issue in cursory fashion. It concluded that inasmuch as the secured party was not entitled to a deficiency judgment because it had conducted the sale in a commercially unreasonable manner, the impairment of collateral holding of the trial court was "superfluous" and "we need not address it."

DISPOSITION OF COLLATERAL UNDER REVISED ARTICLE R9

As regular readers of the Cautious Creditor® know, Indiana has adopted Revised Article 9 of the UCC (R9), which becomes effective on July 1. How should the cautious creditor proceed under R9 to dispose of collateral after default?

The secured party must give a detailed notice that it intends to sell or otherwise dispose of the collateral prior to any sale or disposition. (R9 uses the term "notification.") The notification must identify the debtor, the secured party, the collateral, the method of intended disposition, and the time and place of a public disposition or the time after which any other disposition is to be made. The notification also must state that the

debtor is entitled to an accounting of the unpaid indebtedness and the charge, if any, for an accounting. R9 contains a suggested form of notification which provides sufficient information to meet these requirements. The cautious creditor should ensure that its notice of disposition contains all required information. Any notice providing substantially the required information is sufficient. Additional information does not invalidate the notification. Different rules apply to the disposition of perishable collateral, collateral securing consumer goods transactions and collateral that includes real estate.

The secured party must provide this notification to the debtor, any secondary obligor, any other secured party or lienholder whose interest appears of record 10 days before issuance of the notification, and any secured party or lienholder whose identity is known to the secured party even if no evidence of the lien or claim is recorded or appears of record. Although not required by R9, the cautious creditor should consider sending all statutorily required notifications by a method which provides proof of delivery, such as certified mail with a return receipt.

WAIVER OF DEFENSES UNDER R9

Under current Article 9, a debtor may not waive certain post-default defenses, such as inadequate notice of and the commercial unreasonableness of the secured party's disposition of collateral. Case law is divided on the question of whether these limitations also apply to guarantors. In Walker, the court distinguished between a guarantor's waiver of pre-default disposition of collateral when the guarantor is only secondarily liable, and post-default treatment of collateral when the guarantor faces primary liability. R9 extends the limitations on waivers by debtors to other rights and duties and makes clear that these restrictions also apply to guarantors.

COMMENT

R9 clarifies the steps that the cautious creditor must take to dispose of collateral, but with the clarification comes increased risk for the secured party who fails to pay attention to details. A secured party who fails to comply with R9's disposition rules is liable to the debtor (or guarantor) for damages for any loss caused by the non-compliance, including losses resulting from the debtor's inability to obtain financing, the increased costs of alternative financing or the loss of any surplus that a commercially reasonable sale may have generated.

PUBLICATION INFORMATION

For more information in this area, please contact Susan R. Brooke at (317) 236-5925, or e-mail brooke@icemiller.com.

Ice Miller's Creditors' Rights and Commercial Law Practice Group provides practical advice and aggressive representation to financial institutions, small businesses and regional and national industry on commercial law and credit-related matters. Ice Miller welcomes your questions and comments about the Cautious Creditor®. Please direct them to Susan R. Brooke, Henry A. Efromson, Jeffrey A. Hokanson, Michael J. Lewinski, Dennis H. Long, Peggy J. Naile, Dominic F. Polizzotto, Thomas H. Ristine, Richard J. Thrapp, Zeff A. Weiss, or Michael A. Wukmer at (317) 236-2100.

OTHER ICE MILLER PUBLICATIONS

IM GOVERNMENT INSIDER

Produced by the Government Services Section of Ice Miller – contact Lesa Dietrick at (317) 236-2252, Troy Liggett at (317) 236-5827, or Robin Beck at (317) 236-2455 for further information.

INDIANA GAMING NEWSLETTER®

Produced by the Gaming Section of Ice Miller – contact Kay Fleming at (317) 236-2453 or Terry A.M. Mumford at (317) 236-2193 for further information.

THE INFORMED EMPLOYER®

Produced by the Labor Section and the Employee Benefits Group of Ice Miller – contact Michael L Tooley at (317) 236-2118, or Terry A. M. Mumford at (317) 236-2193 for further information.

LITIGATION – RECENT TRENDS AND DEVELOPMENTS

Produced by the Litigation Section of Ice Miller – contact Arthur P. Kalleres at (317) 236-2208 or James L. Petersen at (317) 236-2308 for further information.

For additional copies of current publications, contact the Business Development Department at (317) 236-2159. Please visit our Internet Web site at www.icemiller.com for more information about Ice Miller.

This publication is intended for general information purposes only and does not and is not intended to constitute legal advice. The reader must consult with legal counsel to determine how laws or decisions discussed herein apply to the reader's specific circumstances. Copyright 2001 Ice Miller. All rights reserved. The Cautious Creditor® is a registered trademark of Ice Miller.